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How governments are helping big companies pay less tax

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Corporate tax policy says more about power than anything else. Corporations seek to minimise the tax they pay – and, while governments ordinarily try to maximise their revenues, in the case of transnational corporations (TNCs) they also understand that they have to tread carefully. Governments have come to accept that they hold fewer and fewer cards as capital has become more mobile.

They’ve worked on their electorates in order to drive this message home. During the early period of the 2010-2015 coalition, George Osborne and David Cameron set out their own views by stating that they needed to ensure: “that the way the tax system operates for UK headquartered multinationals does not inhibit commercial business practices or make them unattractive to international investment”.

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Google vice president Matt Brittin (right) and John Dixon, Ernst and Young’s head of tax (left), giving evidence to a Public Accounts Committee on tax avoidance in 2013. PA / PA Archive
Trade and competition rules mean that some of the traditional methods of protecting businesses – the imposition of tariffs and the allocation of business subsidies – have been challenged. In such an environment, governments have looked for new inducements to maintain existing, or capture new, business investment and corporate taxation has offered new opportunities in this regard.

The key developments in national tax policies begin to make a lot of sense against this background, especially when we factor into the mix higher public debt levels and large national deficits. Governments have seldom been as desperate to capture the revenues owed to them and close the various tax avoidance schemes that prevail. International interest in corporation tax peaked in the aftermath of the post-2008 economic crisis. And the manner in which the UK Parliament’s Public Account’s Committee, chastised some of the largest and most successful companies for tax avoidance caught many, including the companies involved, by surprise. Parliament wasn’t supposed to talk to major corporations in this way.

We shouldn’t separate the investigations of the Public Accounts Committee from the context of the crisis. For a brief moment at least, major corporations were on the back foot. Public trust in big business – and in the banks in particular – was at an all-time low. The government had an opportunity to tackle the problem of corporate tax abuse and of closing the substantial deficit. However, many governments also recognised that, in the area of tax, they had to act multilaterally in order to ensure that they didn’t simply scare off investors to more favourable tax regimes. And it is out of this that international initiatives, including the OECD’s Base Erosion and Profit Shifting initiative (BEPS), have evolved.

Pay little pay late

The basic strategy for most corporate tax avoidance is simple: TNCs seek to design their businesses so that they pay as much income as possible in countries where taxes are low and as many costs as possible in jurisdictions where the statutory tax rate is high. Low standards of transparency in corporate financial reporting, differences in what should be included in estimates and disagreements over the meaning of corporate tax avoidance have produced varying estimates. The UK government estimates that the difference between the amount of tax expected and the actual amount paid was £4.1 billion in 2010/11 (the most recent estimation year available), although independent estimates put the figure at around £12 billion.

Avoidance stems from a similar set of pressures to corporate tax competition: corporate lobbying and structural pressures on successive governments to induce businesses to invest. These same drivers have created a vast range of broadly defined tax benefits – which increase the opportunities for tax avoidance and help to lower the effective tax rate.
Findings from the UK have revealed the fuzziness of the rules regarding corporation tax. Creativity in the interpretation of tax rules is embedded in the institutional processes used to develop them. Large accountancy firms second staff to the Treasury to provide advice on formulating tax legislation so that when they return to their firms, they have inside knowledge of how to identify loopholes in new legislation and advise their clients on how to take advantage of them.

Playing the system

The ability of firms to interpret tax rules creatively also reflects the imbalance of resources between accountancy firms and tax authorities. In 2009, the four major accountancy firms alone employed nearly 9,000 people and earned £2 billion in the UK and as much as US$25 billion globally from their tax work; an estimated 50% of their fees now come from “commercial tax planning” and “artificial avoidance schemes”. In 2012, HMRC reported that it had 1,200 staff overseeing 783 large businesses, in respect of which £25 billion in tax was potentially outstanding. There are now around four times as many staff working for the accountancy firms on transfer pricing alone. And even where companies have been accused by HMRC of having underpaid taxes, the outcome has tended to be a negotiated settlement – an unequal process given the different resources available to the two sides and governments’ need to create a pro-business environment.

The potential weaknesses of co-operative approaches are illustrated by the UK’s Disclosure of Tax Avoidance Schemes (DOTAS), which requires companies engaging in tax avoidance to disclose their avoidance activities to HMRC which, in turn, rules on their legality. If legal, the tax avoidance scheme can be used for financial gain until HMRC acts to close the loophole that makes it possible.
Unsurprisingly, DOTAS has had little impact on the use of aggressive schemes, largely because HMRC lacks the necessary resources to take effective pre-emptive measures.

**Cosy deals**

It isn’t just companies that governments are doing battle with over taxation, it is also other states. Apple has negotiated a special tax rate with the Irish government, resulting in its affiliates paying 2% or less since 2003. Starbucks has also apparently reached a similar “secret” deal with the Netherlands tax authorities. Amazon’s tax deal with Luxembourg is so generous that the European Union is currently investigating it as potential state aid to the company.

Evidence of bespoke tax deals reached between corporations and governments throws into question the very sustainability of the corporate tax system and raises serious questions about the alignment of government and corporate interests and its effects on tax revenues and public spending in future. It also raises questions about the lengths governments will have to go to in future to entice companies to invest and suggests that international agreement on corporate tax competition may be further away than is presently thought.

The key question is whether BEPS will reduce corporate tax avoidance. The OECD, upon releasing its final report, stated that the new tax agreement will increase the corporation tax take and restore trust in the fairness of tax systems. But there is still a long way to go before the BEPS reforms can really be considered to offer a way of tackling tax avoidance.

Country-by-country reporting, for example, will provide country-level disclosures that are unlikely to be transparent and readily available in anything like the format required to facilitate true international cooperation to act on tax avoidance. Moreover, while the rules about taxing economic
activity are clearer, there has been no movement on the taxation of corporate subsidiaries so that they will still be treated as independently trading entities. This will do very little, therefore, to eradicate tax avoidance through transfer pricing.

Of course, no international agreement will reduce the pressure, much of it self-imposed, on governments to compete vigorously with other governments in the area of taxation. The UK government has a clear strategy to compete in such terms and has laid out its own stall by setting one of the lowest rates of corporation tax in the OECD.

There is nothing surprising about the fact that corporations should seek to minimise their tax bill. What is more surprising and worrying is the extent of the problem and the fact that governments also appear to be colluding in the practice. The battleground is no longer between corporations and governments, but between governments and governments, each one keen to attract new private sector investment with increasingly attractive inducements to companies to facilitate such investment. With all this going on, the big transnationals may be excused for thinking that such permissiveness is simply part of the overall package of inducements.